

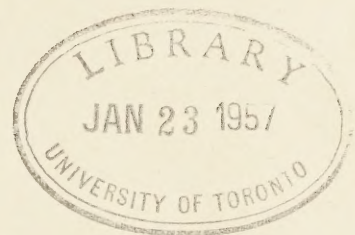
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Canada, Prime Minister's Office

GRAND TRUNK PACIFIC RAILWAY
4 PER CENT DEBENTURE STOCK

REPLY




BY

THE GOVERNMENT OF CANADA

TO THE

REPRESENTATION, ETC., FROM THE STOCKHOLDERS'
COMMITTEE TO THE RIGHT HON. THE PRIME
MINISTER OF THE DOMINION
OF CANADA



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MEMORANDUM

RESPECTING THE

REPRESENTATION

From the Stockholders' Committee to the Rt. Hon. the
Prime Minister of the Dominion of Canada

- The Stockholders' Committee present a lengthy and closely reasoned argument in support of their claim for recognition of the debenture stock-
holders, and a resumption of the interest payments. *Claims of the holders of the G.T.P. Ry. Co's 4% debenture stock.* They admit that as against the Grand Trunk, their claim for interest is non-cumulative and contingent on a condition as to Grand Trunk net operating surplus, which condition for some time admittedly has not prevailed; but, as against the Grand Trunk Pacific, they contend that their claim for interest is
cumulative and non-conditional. They claim further that under pre-war conditions, the net income of the Grand Trunk, after payment of its own fixed charges, would have sufficed to meet the liability of the Grand Trunk Pacific debenture holders, and that, as was done in other countries, the Government should have secured to the railways that pre-war income during the war period. In view of the improved showing during the first six months of 1922 (the Representation is dated November 15 last), they asserted that it was reasonable to assume that the net income of the parent company would again be sufficient to meet the contingent liability. This, however, did not prove to be the case, so far as 1922 is concerned, as last year the net deficit of the Grand Trunk Railway Company of Canada was \$8,411,734.

THE 1913 GRAND TRUNK DIVIDEND

As to pre-war income, the British Government took the 1913 results of operation as a basis of standard return during the period of Government control. Judge Taft states, in his Reasons for Dissent, that the 1913 revenues of the Grand Trunk "were improperly increased apparently in order to justify the declaration of a dividend on the three series of preferred stock." Therefore, it cannot be maintained that the Grand Trunk would have been able, on a pre-war basis, to take care of its contingent liability in respect of the Grand Trunk Pacific debentures. It was established at the arbitration that the revenue from the operation of the Grand Trunk Railway Company of Canada in 1913, after making provision for fixed charges—but without provision for depreciation of equipment—was \$2,874,592, and that the profits of subsidiary companies not taken into the accounts of the Grand Trunk Railway Company were \$484,638. Notwithstanding this, the Management paid out to guaranteed and preference shareholders dividends amounting to \$4,736,241 in 1913—and during that year a number of the unfortunate investors now appealing to the Canadian Government for compassionate consideration bought Grand Trunk preferred stock. Taking the net revenue from rail-

way operation for 1913, and providing properly for depreciation—from \$2,000,000 to \$2,500,000—it is clear that the contingent liability could not have been met.

PREFERMENT OF GRAND TRUNK GUARANTEED

Considerable space is devoted to the question of the preferment of the Grand Trunk guaranteed stock over the Grand Trunk Pacific debentures which, it is claimed, rank ahead of it. The officials of the Department of Railways, who had to do with the negotiations with respect to the acquisition of the Grand Trunk, very well recall that the inclusion of the Grand Trunk 4 per cent guaranteed stock was insisted on by Grand Trunk representatives, who claimed that otherwise it would not only be difficult, but perhaps impossible, to secure ratification of the agreement. It was this, no doubt, that led Mr. Meighen, in his letter of July 11, 1918, to state that "*should the company desire,*" the guaranteed stock might be treated as an obligation in the same way as the company's bonds. The matter was optional, and, quite clearly, volition was with the company. The argument on behalf of the company is that it assumed that the Government, in guaranteeing the Grand Trunk 4 per cent guaranteed stock impliedly became responsible for the Grand Trunk Pacific 1113. 4 per cent debenture stock, but the obligation definitely to protect the position of the Grand Trunk Pacific debenture holders was on the Grand Trunk because the Grand Trunk guaranteed shareholders—as pointed out by the Stockholders' Committee—were among the guarantors who had previously contracted to place the Grand Trunk Pacific debentures before their own stock.

However, it is fruitless to argue the responsibility, if any, for the lack of specific direction or understanding as to the position of these Grand Trunk Pacific debentures, which it should be observed were not guaranteed by the Government. It is true that the Government offered originally, under certain conditions as to payment, to assume all obligations of both the Grand Trunk and the Grand Trunk Pacific. 1113. That offer was not accepted. It was a long-term rental offer verging on perpetuity. The arrangement finally reached was to acquire the Grand Trunk capital stock, and, in that way, control of the physical property. Under that arrangement, only Grand Trunk stocks and shares were specifically enumerated in the acquisition agreement, but the undersigned are clearly of opinion that it was never the intention of the Canadian Government that the inclusion in the protected class of the Grand Trunk 4 per cent guaranteed stock—the property of shareholders merely—should in any way be construed as an impairment of the position of Grand Trunk Pacific debenture holders ranking as creditors.

SHOULD CANADA BEAR ALL THE LOSS?

This leaves the position of the Grand Trunk Pacific debenture holders to be considered on its merits in relation to the Grand Trunk Pacific project which, since March 10, 1919, has been in receivership. It would doubtless have simplified matters, both as regards the Grand Trunk Pacific and the Grand Trunk, had the companies been permitted to go through regular process of bankruptcy. But in view of the abnormal conditions during and immediately following the war, and the necessity for stabilizing as far as possible, trade, commerce and industry, the Government of the day considered it advisable in the national interests to deal directly with the situation, rather than through ordinary court processes. This was the procedure followed in connection with the Cana-

173. dian Northern during the war, and the same action was taken with respect to the Grand Trunk group following the war. Unfortunately, this consideration by the Government does not seem to have been appreciated by investors abroad. Generally speaking, their attitude appears to be that if there is to be any loss, the Canadian Government and the Canadian people should shoulder it. They overlook the fact, as pointed out by Mr. Meighen in his London offer of July 11, 1918, already referred to, that "the ever-increasing interest obligations binding on the Grand Trunk Railway towards its subsidiary company were not paid by the Grand Trunk Railway Company, but were taken care of out of the proceeds of loans made by the Government of Canada" to the Grand Trunk Pacific, and although the Grand Trunk Pacific Company defaulted its obligations and abandoned operations in 1919, the debenture holders now contend that their claim for interest is unbroken and cumulative.

\$12,000,000 IN INTEREST PAID DEBENTURE HOLDERS

The authorized issue of these debentures was \$50,000,000, of which there is outstanding \$34,879,252.86, on which the annual interest amounts to \$1,395,170.12. The total amount of interest paid to these debenture holders to March, 1919, was \$12,363,358.88, of which sum \$7,944,320.17 accrued to December 31, 1915, which date technically marked the completion of construction of the Grand Trunk Pacific Railway Company, though, to make it easier for the Company to finance, that period had been prolonged by the Government beyond strict requirements. Under the terms of the contract certain charges became a liability against income only when the road was officially declared to have been completed.

173. After 1915, therefore, interest on the debentures became an income liability, and to that account the balance of the interest payments—\$4,418,038.71—is charged; but at no time between January 1, 1916, up to the abandonment of the road by the Grand Trunk Pacific Company in March, 1919, nor since that period under the receivership, have the revenues of the Grand Trunk Pacific been sufficient to meet operating expenses, let alone interest. As the interest was paid by the Grand Trunk Pacific Railway Company up to and including March, 1919, it is obvious that the payments were made with borrowed money, either that derived from capital or from loans.

It may be asked why the Grand Trunk, as guarantor, did not itself make these interest payments in view of the claim of the Stockholders' Committee as to the sufficiency of the pre-war net surplus to meet the obligation. Interest on the issue was first paid in September, 1907, but as already explained the Grand Trunk did not, at any time, meet the charge prior to December 31, 1915, nor afterwards.

WHEN THE GRAND TRUNK SHOULD HAVE MET THE CHARGE

As already mentioned 1916 was the banner year in Grand Trunk history. It was doing a big war business and the heavy wage increases of 1917 and 1918 were still of the future. Out of the income of the year 1916 the Grand Trunk Railway Company declared dividends on the following issues of its capital stock::

4 per cent Guaranteed Stock	\$2,433,333.33
1st Preference Stock	831,428.64
2nd Preference Stock	615,244.16
Total Dividends	3,880,006.13

After applying charges for the said dividends to the income for the year 1916 there was left a surplus for the year of \$24,428.19. No dividends were declared by the Grand Trunk Railway Company after the year 1916.

It is contended that the Grand Trunk Pacific debentures ranked prior to any of the three above mentioned securities favoured by the dividend declarations of the Grand Trunk Directors in 1916. The Grand Trunk could have met its guarantee in respect of these debentures only in that year. But to have done so would have made it impossible to declare dividends on the above mentioned securities, so the Grand Trunk Pacific followed the easier course, paying the interest out of borrowed money.

➤➤ WHAT CANADA HAS DONE ➤➤

N.B. Having reviewed in this manner the attitude of both the parent company and the subsidiary to the interest charge in question, it is only fair to Canada that the attitude of the successive Canadian Governments in dealing with the Grand Trunk Pacific be briefly referred to. The total advances by the Government to the Grand Trunk Pacific Company to December 31, 1922, amounted to \$90,558,034.75. Of this sum, \$31,-512,074.66 was required for betterments; \$6,417,729.83 for equipment; \$25,985,065 for operating deficits and \$26,623,165.26 for fixed charges. On these advances, unpaid interest has accrued amounting to \$20,924,-521.32.

Contrast this with the position of the debenture stockholders. The Government has advanced more than \$90,000,000, and has had no interest whatever—the debenture stockholders invested less than \$35,000,000, and have had interest aggregating \$12,362,358.88. It may also be expressed in this fashion: The Grand Trunk Pacific owes the Government approximately \$21,000,000 in unpaid interest alone, the debenture stockholders have missed eight half-yearly interest payments amounting in all to \$5,580,680.

The ninety millions referred to is far from being an exhaustive statement. In recent weeks Parliament was called on to vote \$10,320,232 additional on Grand Trunk Pacific account for the current year. Nor does it take into consideration the capital cost of the construction of the Eastern Section, known as the Transcontinental, from Winnipeg to Moncton, amounting, irrespective of interest, to \$168,000,000, nor \$33,000,000 expended to buy in Grand Trunk Pacific bonds, after approximately \$5,000,000 had been paid to implement to par bonds publicly disposed of previously. Nor does it take into account the \$104,560,342 loaned to the Grand Trunk, nor 50 millions of recent guarantees to that Company—rendered necessary largely because of its entangling alliance with the Grand Trunk Pacific.

REPEATED DEFAULT OF THE GRAND TRUNK PACIFIC

The Stockholders' Committee stress the legal and moral claim of the debenture holders and the desirability of Canada keeping faith with those who have placed their money in the Grand Trunk Pacific enterprise. We will deal with the legal aspects in due course and without desire or intention to minimize it. But as to moral claim and keeping faith we feel that the Stockholders' Committee should recognize that such desiderata ought fairly to extend in both directions. Nowhere in its Representation has the Committee taken cognizance of repeated defaults of the Grand Trunk Pacific Company, first, with respect to the lease of the connection between its Lake Superior Branch and Winnipeg, and, secondly, as respects the lease, equipment and operation of the Ans.

Tronscontinental, which have severely taxed the Government, and in connection with which operating deficits amount to sixteen millions. By contract, it will be found on examination that the Government has more than observed its part of the Grand Trunk Pacific agreement, under which it was not obliged to do more than guarantee the bond issues necessary to enable the Company to finance its own construction. In view of all this, the attitude of the British investors and press towards the Canadian Government has scarcely been considerate.

Ans. The Stockholders' Committee repeat the charge that the Government permitted rival railway lines to build into Grand Trunk Pacific territory. This assertion is not borne out by the facts. The Canadian Northern was within three months of actual completion between Port Arthur and Edmonton when the first sod was turned on the Grand Trunk Pacific. And as for criticism of inadequate rates, it should be remembered that relatively equal rates must be permitted on all roads. In Canada the control of rates is not in the hands of the Government, but of a tribunal created for the purpose—the Board of Railway Commissioners. That Board repeatedly took action to equalize rates and increasing working expenses, and the Grand Trunk group enjoyed the same relative rates as the Canadian Pacific which was able, because of its stronger position, to surmount its difficulties. In an endeavour to provide adequate rates, Parliament, in addition, went so far as to set aside, during the war, a statutory agreement as to rates beyond the control of the Railway Board, and which vitally affected all of Western Canada. Ans.

AS TO LEGAL LIABILITY

There remains for consideration the legal aspect. There is no question but that the claim is legally enforceable against the Grand Trunk Pacific and against the Grand Trunk within the limits of the latter's conditional guarantee. There being no Government guarantee, it is not enforceable against the Government. On the other hand, notwithstanding the inclusion of the Grand Trunk guaranteed stock in the protected class, dividends on that security cannot be paid out of Grand Trunk funds while the interest on the senior Grand Trunk Pacific 4 per cent principal debentures is not being paid. Thus the guarantee of the Grand Trunk 4 per cent guaranteed stock is at present a charge not on the earnings of the Grand Trunk, but on the Government direct. Answer

However, this legal liability is limited to the satisfaction which the property is able to provide, and the debenture stockholders may claim only the remedy to be afforded by the sale of the property. It is singular that Grand Trunk Pacific debenture holders quite fail to appreciate that the company in which they invested their money long since became defunct, and that in ordinary process of law their equity would assuredly have been extinguished at that time. It had been in receivership two years at the date of the arbitration and is still in receivership. A liquidation of the property in attempted satisfaction of the debenture holder's claim was discussed by Judge Taft in his Reasons for Dissent from the Grand Trunk Award, when he expressed the following opinion:— MS.

“I cannot for the life of me see any hope that by a sale of the Grand Trunk Pacific's property, a sum could be realized that would more than satisfy the first lien of the Receiver's debts, which have now become nine millions, and the prior debentures amount to \$38,000,000 guaranteed by the Government.”

Of course the prior lien of the Receiver has grown greatly since 1921, and now amounts to \$39,432,475.78. It continues to grow, and will continue to grow until the receivership is ended.

The debenture Shareholders' Committee declare that there must be no merging of the National Lines, as that would prevent the possibility of ascertaining when the Grand Trunk's conditional guarantee would become operative, or when Grand Trunk Pacific earnings might be such as to permit the enforcement of their claim. Likewise, they hold that there must be no diversion of traffic, or abandonment of lines, or mixing of equipment, as such would be prejudicial to the position of the debenture stockholders.

We recognize clearly and distinctly the obligation of the Grand Trunk Railway Company of Canada and of the Grand Trunk Pacific Company to meet the debenture interest charges as and when there are sufficient earnings. It will add to the difficulties and expense of the National Lines to be obliged to maintain indefinitely separate accounting for these component parts of the System, but it is not impossible and, as a matter of fact, is being done. We do not lose sight of the advantages that would follow a more simple method of accounting, and the continuation of the present system will cause annoyance, inconvenience and loss, but inasmuch as under the terms of debenture issue it is necessary to provide the separate showings, the railways will continue to maintain these several accounts.

In conclusion, your Committee would like to correct a curious misapprehension which appears to exist abroad as to these Grand Trunk and Grand Trunk Pacific properties. To read the comments of and letters appearing in the British press one would think that the Canadian Government had selfishly acquired a most lucrative enterprise and was endeavouring to divert profits from English investors to the treasury of Canada. If that were a fact such claims as the Canadian Government has been called upon to consider in this connection could scarcely be denied, but the truth is, as we have endeavoured to show in the detail ^{Answered} ⁽¹⁾ of our present argument, the Government of Canada took over properties in virtual bankruptcy and every hour since that acquisition was effected, and every day, has added to the burden to be supported by the Canadian taxpayer. Is the fact that the Government of Canada has poured out its money in this way to save these companies from disaster any reason why it should now undertake new expenditures as to which it is under no moral or legal obligation? It is in the highest degree important that British investors realize that these properties, instead of being profitable enterprises are in point of fact adding immensely to the financial embarrassment of the Dominion.

And there is this added thought: The Grand Trunk of 1923 is not ⁽²⁾ the Grand Trunk of 1920, any more than the Grand Trunk Pacific of 1919 is the Grand Trunk Pacific of to-day. The Government had had to find much money and credit before these roads were acquired. But since those dates, the Government has had to find more than two hundred millions in cash and fifty millions in credit. It has provided a reorganized and efficient resident Management who will expect any credit there may be for improved showing. Canada has had to assume this burden, whether it wished to or not, and we respectfully suggest that the Canadian Government and the Canadian taxpayer are, under the circumstances, entitled to sympathy rather than reproach or condemnation.

OTTAWA, July 6, 1923.

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